



1958

First National City Bank Monthly Letter Business and Economic Conditions

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General Business Conditions

THE business upswing has carried farther in November, and fall business, taken as a whole, has been encouraging. Businessmen, although still cautious in their ordering and inventory policies, look for continuing recovery. During November seasonally adjusted measures of production, construction, and retail sales appear to have maintained or improved upon the moderate gains they registered in October. Automobile output is now accelerating in order to stock dealers, and is having a favorable impact on a wide variety of suppliers, notably steel mills, where operations have currently leveled off at about 75 per cent of capacity.

In October factory employment, hours of work, and personal income suffered slight setbacks, chiefly because of strikes in the auto industry, but industrial production, as measured by the seasonally adjusted Federal Reserve index (1947-49 = 100), advanced one point to 138. In the first four months of the upturn the index

rose ten points, but in the two following months it inched up only two points farther. This is the "leveling out" which so many observers see. Few, however, find in it any evidence that the rise is ending or the trend reversing. After rapidly regaining nearly two thirds of the ground lost, a slowing down is not discouraging. Good support for industrial activity is evident in most major lines, as shown by improved new orders and by the greatly diminished rate of inventory liquidation. The automobile industry can be expected to contribute more to the production index in the winter than it was able to do during the fall, because of the strikes.

More fundamentally, the recovery will be more soundly based, less vulnerable, and likely to go further in the long run if restraint is shown now. The indexes would rise faster if businessmen were building inventories more rapidly, speculating more in commodities, and planning capital expenditures with greater optimism — and if there were no rein on government spending. But such policies would bring only a short-lived boom, in which, according to experience, the recent productivity gains would shrink, costs and prices rise, and new causes of instability and recession appear. Fortunately, despite widespread talk of potential inflationary pressures, the recovery to date has been accomplished without appreciable increases in the over-all level of either wholesale or consumer prices. Basic industrial materials prices have advanced, and farm prices have declined, but finished goods prices generally have moved within a narrow range. Even prices of consumer services appear to be topping off their prolonged rise.

Nondurables Lead the Rise

The rise in production has been uneven. Nondurable goods output as a whole in October was at a new record, 2 per cent above the pre-recession peak. Six of the twenty major manufacturing industries included in the indus-

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trial production index have advanced beyond their 1956-57 peaks. Five of them — chemicals, paper, food, tobacco, and apparel — are non-durable goods lines; only one — furniture — is in the durable goods category.

Over-all production of durable goods has risen somewhat more rapidly than that of nondurables, but as the initial drop was so much sharper, the durable goods index is still 12 per cent below its previous peak. Some lines, notably machinery and transportation equipment, have recovered only a minor portion of the ground lost during the recession. Consumer and business demands for durables are thus the lagging factors in the recovery.

The key to a good year for consumer durables lies with automobiles and home building. Government and private experts anticipate housing starts next year equaling or slightly exceeding this year's total of 1,170,000 units (public and private). This would imply a moderate drop from the October rate.

In the case of passenger cars, observers generally expect increased sales and production in 1959, but guesses range all the way from 10 to 40 per cent above this year's poor record of 4¼ million domestic cars. Arguing for a good car year are high consumer incomes, reduced instalment debt, and good trade-in prices. It may be January or February, however, before acceptance of the new models can be gauged.

New model sales through the first ten days of November were not up to expectations, perhaps largely because of inadequate dealer stocks. Output of more than 1.1 million cars — a quarter of this year's production — will be crammed into November and December, as factories resort to overtime and double shifts to stock dealers and fill order backlogs. Even under most optimistic sales estimates, output cannot be sustained at this accelerated pace for more than a few months.

The recent sidewise movement of employment and personal income has contributed to a continuing cautious attitude of consumers toward major purchases. Nonagricultural employment, seasonally adjusted, moved up only 1 per cent in the first six months of recovery. While unemployment reached a 1958 low in October of 3.8 million persons, it is still a problem in many areas. Wage losses arising from strikes temporarily halted the rise in personal income. At the same time, transfer payments, such as unemployment insurance and other benefits, turned down — a reminder that these "automatic stabilizers" work in both directions.

Undoubtedly consumer confidence and durable goods spending will be influenced largely by the speed of recovery in incomes and employment.

Capital Investment Decline Halted

Businessmen reporting to McGraw-Hill in October indicated plans to spend about the same amount on new plant and equipment in 1959 as in 1958. This confirms earlier evidence that the drop in new capital outlays has leveled.

These plans for capital spending are not firm, but are, rather, an expression of businessmen's intentions at the time the survey is made. Revisions in next year's anticipated expenditure totals are to be expected, but from all indications changes are most likely to be upward.

In deciding to change investment programs, management will be guided importantly by profit trends. Recent profits reports have been encouraging. The preliminary findings of this Bank's quarterly tabulation of corporate earnings, published a month ago, have been confirmed by an updated study, expanding the original sample from 708 firms to 1,228. This shows that corporate net income after taxes in the third quarter of 1958 advanced 16 per cent over the second quarter.

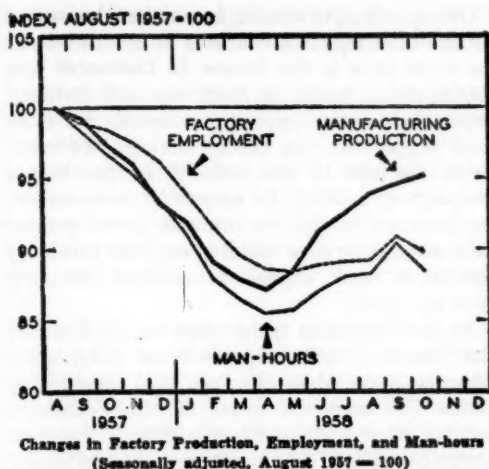
Despite this sizable gain, profits were 7 per cent less than a year earlier and still farther below the peak reached early in '57. Encouragement comes chiefly from the fact that, after a prolonged squeeze by rising costs, profit margins are recovering.

Productivity Increasing

A major factor behind the improvement in profit margins is the rise in productivity which has taken place since early spring. The increase in output per man-hour is illustrated roughly by the widening spread between manufacturing output and man-hours worked.

Through economy measures and improved efficiency, business has been working its way out of the cost-price squeeze on profits. On the whole, price levels have held fairly stable, despite further advances in wage rates. While relief has come partly through ability to spread overhead costs over a greater number of units as business has recovered, the major factor is that the billions of dollars invested in new and more efficient facilities are paying off.

To the extent that this improvement in profit margins provides businessmen with leeway to absorb rising costs without boosting prices, inflationary pressures are diminished. To the degree also that more adequate profits provide in-



centive for businessmen to increase their investment in new plant and equipment, to go ahead with new products, and to undertake new enterprises, the economy will be strengthened and additional jobs created.

Treasury Bill Financing

Continuing to finance its deficit at short term, the U.S. Treasury followed up its sale in October of \$2.7 billion 3½ per cent "special" Treasury bills due May 15 with a \$3 billion issue of June tax anticipation bills in November. The new "TABs" were auctioned at an average rate of 2.997 per cent. The lower borrowing cost reflected some intervening decline in short-term open market money rates as well as the special attraction to corporations of securities which are timed to mature at quarterly tax dates.

Meanwhile, holders of \$12.2 billion certificates and bonds maturing in December were offered in exchange a choice between 3½ per cent 11½-month certificates at a price of 99.95 to yield 3.43 per cent and 2½-year 3½ per cent notes at 99½ to yield 3.68 per cent. In the bond market a better tone attracted offerings from the World Bank and several foreign governments, but the Treasury again deferred approach to the long-term market.

About two thirds of the December maturities were held by the Federal Reserve Banks which, as usual, took new securities in exchange. Private investors exchanged 88 per cent of their holdings, most preferring the shorter-term certificates. This left \$535 million for redemption in cash, mainly by corporations which had been holding the maturing obligations against December tax and dividend payment requirements.

New 182-day Bills

In announcing terms for refunding its December maturities, the Treasury disclosed that it will raise \$2.6 billion additional cash on Treasury bills over the 13 weeks beginning December 11. This would supply more than half the \$4 to 4½ billion the Treasury figures it needs to raise from December through March.

The plan is to issue a new series of 182-day (26-week) Treasury bills. There are now outstanding 13 weekly issues of 91-day Treasury bills, each in the amount of \$1.8 billion, for an aggregate of \$23.4 billion. Each week the Treasury auctions a new issue to raise money to pay off the one coming due.

The total amount of regular bills will be increased to \$26 billion. While this could be accomplished by increasing the cycle of 91-day offerings to \$2 billion each, issuance of the new 182-day bills will avoid raising the weekly rollover of 91-day bills to such dimensions and will also tap 3-6 months money. The Treasury could eventually seek a single 26-week bill cycle. For fear of market resistance to longer-dated bills, however, 91-day bill offerings will be indefinitely continued, though perhaps in reduced amounts. Thus the market will have a chance beginning December 8 to bid for both "long" and "short" bills.

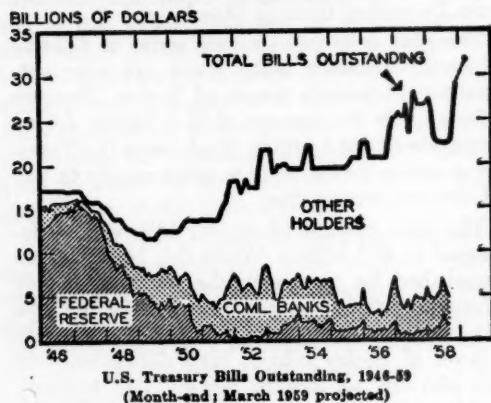
Background on Bills

Following the British example, Congress authorized Treasury bills on June 17, 1929. They were designed to be sold at competitive auction, permitting the Treasury to get the lowest interest cost consistent with current market conditions, and were set to mature at times when the Treasury expected to have excess cash. It was not until 1938, with the public debt constantly growing, that a 13-week cycle of weekly issues and maturities was introduced.

In effect, the availability of 13 weekly Treasury bill issues, spaced evenly to mature up to 13 weeks into the future, put the Treasury more or less into a business of soliciting time deposits, with the investor having marketability as a way out if he needed cash in advance of maturity. Improving bill yields, the prohibition on the payment of interest on demand deposits, reluctance of the banks to bid for time deposits, and legal limits on time deposit rates payable by banks all have played parts at one time or another in developing a huge market outside the banks for Treasury bills.

The volume of bills outstanding rose from \$100 million in December 1929 to \$1.3 billion in 1940 and then, with war financing, to \$17.0

billion in 1945. The total was cut back out of surplus revenues to a postwar low of \$11.5 billion in 1949 but then began to rise again. Now a record \$29.1 billion is outstanding, including the \$3 billion June tax anticipation bills and \$2.7 billion "special" bills due May 15. By March the total may approach \$32 billion.



Treasury bills are designed as substitutes for cash, finding buyers among holders of temporarily idle or reserve funds: corporations, governmental bodies, banks at home and abroad, and a miscellany of buyers who appear when rates are "good."

The vast postwar growth in nonbank ownership of Treasury bills, shown in the chart, reflects the power of attractive rates. During World War II, when the bill rate was pegged at $\frac{3}{4}$ per cent, Treasury bills gravitated into the Federal Reserve Banks. In June 1947, just before the Federal Reserve withdrew its fixed peg and allowed a gradual increase in yield, the Reserve Banks held no less than 92 per cent of all outstanding bills. Since then, with freely fluctuating rates which have ranged up to 4.17 per cent on one special issue in 1957, the market outside the Federal Reserve and commercial banks has expanded more than thirty-five times.

Treasury Bills and Inflation

Many people see no objection to Treasury bill finance so long as the bills are placed outside the banks and are not paid for with newly created deposits which inflate the money supply. The Treasury has had a great deal of success so far in placing the bulk of the \$11.5 billion of short-term securities sold for cash since July with corporations and other nonbank short-term investors. The price has been higher rates, 91-day bill yields advancing from below 1 per cent in July to an average of 2 $\frac{1}{2}$ per cent in October and November.

One question, of course, is whether the market outside the banks can continue to absorb bills at the same pace in the future. In December and March, when needs to cover tax and dividend payments narrow corporate demands for bills, bank support for the market may be needed if yields are not to rise unduly. In the longer perspective, it would be surprising were corporate demands for bills to continue at the present scale when inventory building replaces inventory liquidation and capital investment spending turns up again.

No less important is the often overlooked fact that Treasury bills represent an inflationary influence even when they are held outside the banks. The corporate buyer of bills exchanges cash for what Federal Reserve Board Chairman Martin has called "the closest equivalent to money that there is." Some weeks or months later the holder has an undeniable right to cash from the Treasury. Meanwhile, the Treasury spends the deposits it has received from the corporation, activating what were idle balances. In short, the turnover of the existing money supply is increased by Treasury bill finance, permitting spending to go forward in spite of restrictive Federal Reserve credit policies.

Heavy reliance on bill finance is dictated by the size of the deficit, the reluctance of the Treasury to attempt a bond issue, and the fact that the Federal Reserve conducts its open market operations in bills and may help see that bills have a market either by direct buying or by expecting banks to buy and cover with borrowings from the Federal Reserve Banks.

The Treasury has always had more than enough bids to cover its Treasury bill auctions but the margin to spare narrowed dangerously on two occasions, in the June 1953 and August 1957 credit squeezes. If bills are issued beyond the capacity of the market to absorb them, and the Federal Reserve has to help out, the effectiveness of credit restraint will be impaired. Here we have an illustration of the threat of an unmanageably large deficit to the value of money.

The Gold Outflow

Between February 19 and November 26, 1958, the United States gold stock declined by \$2.2 billion, a drop already exceeding that for any previous calendar year. To be sure, the United States is still holding \$20.6 billion, over one half of the Free World's monetary gold, estimated at \$39.5 billion. The \$20 billion gold held as reserve for the Federal Reserve Banks still exceeds by an \$8 billion margin the statutory requirements against Federal Reserve note and deposit

liabilities. But the magnitude and the speed of the current gold outflow raise questions as to what it means.

Redistribution of gold reserves is a good thing insofar as it measures the success of Europe, where the gold has mostly gone, in restabilizing its currencies and rebuilding its industrial competitive power. Demand for gold by foreign central banks and governments also shows the prestige the metal commands as a stable store of value and basis for confidence in paper currencies.

The U.S. needs a strong gold position as a basis for the use of the dollar as an international standard of value and means of payments, and it is for this reason that the gold outflow merits examination from the standpoint of U.S. fiscal and monetary policies. There is little question but that chronic deficits in our balance of payments have created more dollars abroad than foreign nations have needed or wanted to use for purchases here; many American firms are experiencing difficulty in holding their overseas markets. Thus, the challenge emerges of keeping our prices, and dollar supplies, under restraint to help not only United States competitive power in world markets but also confidence in the dollar as a trustworthy and universal standard of value.

The proximate cause of the 1958 gold outflow is the acquisition of excess dollars by Western European countries through transactions with the United States. These countries traditionally have kept the bulk of their reserves in the form of gold. But in earlier postwar years they were equally pleased — as was the world at large — to accumulate dollars which have advantages of being directly available for covering payments and of being investable for an interest rate return in the New York money market. In effect, much of the world went on a dollar exchange standard. And the U.S. has been able to do so much to aid nations abroad financially because they were glad to have dollars as a substitute for and equivalent of gold.

A Shift in Attitude?

That Europe converted so many dollars into gold this year is a measure of European prosperity and surplus dollar accumulation. But other influences were also at work. The easy money policy pursued by the Federal Reserve earlier this year sharply reduced the yield available on short-term open market investments and thus the incentive for foreigners to retain dollar holdings.

Even more important was the emergence, through heavy appropriations and reduced rev-

enues, of the \$12 billion federal deficit. Some shift in attitude toward the dollar became at least faintly visible among foreign central bankers and finance ministers. Some were led to wonder if the United States had not embarked upon an inflationary course that might eventually bring about a devaluation of the dollar. It is the aspect of preference for gold over dollars that creates the potentially critical problem. The U.S. gold stock, while abundant, is not unlimited.

The retreat of the Federal Reserve from its easy money policy has tended to reduce the preference for gold over dollars. The sharp advance in short-term open market money rates since July has improved the return available on holdings of dollars while advances in Federal Reserve Bank discount rates from 1½ to 2½ per cent have evidenced determination of the Federal Reserve authorities to protect the dollar from depreciation. However, while business recovery is strengthening the tax revenues, the federal budget problem remains to be dealt with through curtailment of programmed expenditures and the redevelopment of investor interest in long-term U.S. bonds. It is really up to the Congress whether the gold outflow may continue on a scale likely to impair confidence in the dollar and, with it, U.S. prestige throughout the world.

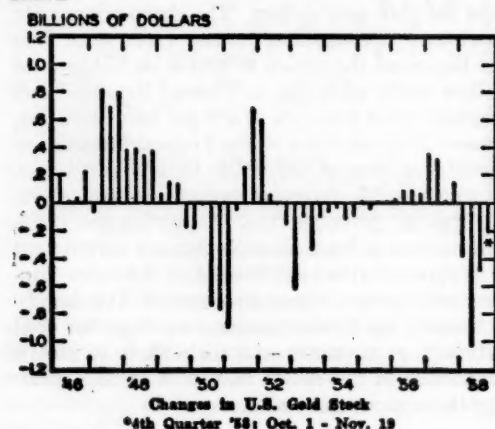
Broader Background

In the broader background, the United States Government since World War II has been supplying dollars as a means of financing economic reconstruction and development and also — since 1950 — with an eye to the threat of Soviet imperialism. These efforts failed to increase currency reserves abroad until foreign countries had succeeded in increasing their output and productivity, corrected overvaluations of their currencies in relation to the U.S. dollar, and discarded cheap money policies. But ever since 1949, when world-wide currency revaluations were consummated, foreign countries (together with international institutions) have almost continuously acquired dollars on balance in their transactions with the United States — no less than \$10.3 billion during the eight years 1950-57. There were only two interruptions — one in the middle of 1951 at the height of the post-Korea inflation abroad; the other during the last quarter of 1956 and the first nine months of 1957 at the time of the Suez crisis and the world-wide inflationary investment boom.

While gold flows figured prominently over the period 1950-57, a remarkable rise occurred in foreign dollar holdings. Of the \$10.3 billion foreign countries gained in their transactions with the U.S., \$2.6 billion net was converted into gold

at the U.S. Treasury. The International Monetary Fund, which wanted additional dollars for lending, mainly to the United Kingdom and France, sold \$0.8 billion to the U.S. in 1956-57. This left an increase of some \$8.5 billion in foreign and international dollar assets.

Gold flows have run both ways. The magnitude and the direction of postwar gold transactions with other countries and the International Monetary Fund are reflected in quarterly changes in U.S. gold stock, shown on the accompanying chart.



Growth of Dollar Holdings

Foreign-held dollars — above working demand deposit balances — are carried in time deposit accounts with major commercial banks or invested in the open market for an interest rate return. The table shows the large growth between 1949 and 1957 in the principal categories of foreign dollar assets.

Dollar Assets Held at U.S. Banks for Foreign and International Account

(In Millions of Dollars)

	Dec. 31, 1949	Dec. 31, 1957	Aug. 31, 1958
Assets held by foreign countries			
Deposits, demand and time	\$4,741	\$ 7,529	\$ 8,710
U.S. Treasury bills and certificates	943	4,688	4,323
Bankers' accept., coml. paper, etc.	226	1,387	1,303
Subtotal	\$5,909	\$13,553	\$14,144
U.S. Govt. bonds and notes	449	1,220	1,009*
Total	\$6,358	\$14,773	n.a.
Assets held by international institutions†	1,817	1,708	1,801*
Grand total	\$8,175	\$16,511	n.a.

* June 30, 1958. † Mostly U.S. demand notes, bills, and certificates. n.a. Not available.

The preference of foreign holders for any particular form of dollar-earning assets — time deposits, U.S. Treasury bills, bankers' acceptances, etc. — is, of course, partly a matter of the spread in the yield among these various forms of investment and partly a matter of taxation.

During the postwar years, there have been few instances of foreign countries' drawing on their pre-existing dollar assets to purchase gold from the United States. The first — and the most significant — of such instances was during the fourth quarter of 1950, three months after the Korean outbreak, when amidst sharp inflationary pressures in the United States foreign central banks not only converted into gold large amounts of newly acquired dollars but also liquidated \$300 million of pre-Korea dollar holdings. Foreign gold purchases came to a sudden halt in April 1951. This reversal undoubtedly reflected many factors, but the most important immediate one appears to have been a marked change in expectations of foreign observers regarding inflationary prospects in the United States. The "Accord" between the Treasury and the Federal Reserve to minimize further monetization of government debt was clearly one of the factors responsible for the cessation of U.S. gold losses.

Swollen Payments Deficit

The \$2.2 billion gold outflow so far this year does not reflect, for foreign nations taken collectively, conversions of previously held dollars. Indeed, as the previous table shows, foreign countries' short-term dollar holdings for official and private account actually increased from December '57 through August '58 (latest available) by \$600 million. Dollars held for official account alone rose by \$484 million. It is true that between the end of December and the end of August, Switzerland and the United Kingdom reduced their short-term dollar assets (the latter from an unusually high level that reflected the \$250 million drawing on the Export-Import Bank line of credit toward the end of last year), but Canada, Germany, the Netherlands and other countries continued to add to their dollar holdings.

The basic factor in the loss of gold has been a large balance of payments deficit with the main gains accruing to European nations which have traditional preferences for gold. During the first nine months of 1958, foreign countries acquired \$2.7 billion net as a result of their commercial and financial transactions with the United States. Thus the year as a whole bids fair to equal the record \$3.6 billion gold and dollar loss of 1950.

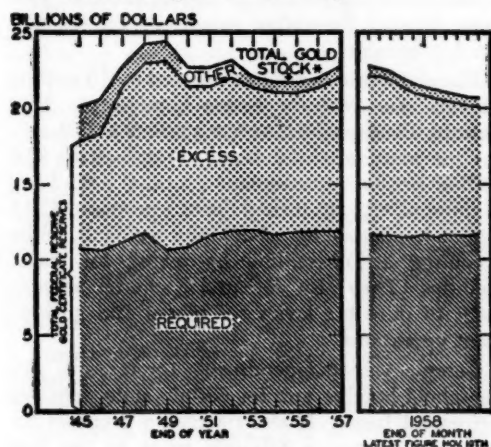
At the time of the Suez crisis in late 1956 and at the height of the world-wide inflationary boom in 1957, the United Kingdom and most of the Continental European countries had lost gold and dollars to the United States; but the passing of the Suez emergency and the restoration of financial stability put an end to excessive imports and capital flight. This in turn brought about a

decline in United States merchandise exports from the unusually high levels of 1957 and some repatriation of foreign short-term funds. At the same time, United States merchandise imports were well maintained. Government foreign expenditures and aids as well as private capital outflow continued at high levels.

Excess Gold Reserves

As against 70 per cent in September 1949, the United States is still holding somewhat over one-half of the Free World's monetary gold stock. The drop in the proportion is explained by movement of new production into foreign reserves as well as by gold purchases from the U.S.

Of the United States gold stock of \$20.6 billion on November 26, \$11.9 billion was required as the 25 per cent legal cover for Federal Reserve note and deposit liabilities. The actual ratio stood on November 26 at 42.2 per cent, as compared with 47.4 per cent on February 19, before the most recent gold outflow began.



U.S. Gold Stock

*Excluding Gold Held in the Exchange Stabilisation Fund (\$106 Million on September 30, 1958).

Gold not required as cover for currency — the excess Federal Reserve gold certificate reserve shown in the chart — stood on November 26 at \$8.2 billion, as against \$10.4 billion last January. It is less than the United States short-term liabilities to foreign countries on official as well as private account, which in August 1958 amounted to \$14.2 billion. Of this amount, however, \$5.8 billion was held by foreign commercial banks, business firms and individuals largely as working balances and reserves against contractual obligations to Americans; such private holdings cannot be used to purchase gold from the United States unless sold to the central bank of the country concerned.

The remaining \$8.4 billion represented holdings of monetary authorities. Although the U.S. has no legal obligation to convert such holdings into gold, it has for almost a quarter of a century followed this practice. The fact is that a large part of these holdings consists of working balances to meet current or prospective payment requirements or to operate in exchange markets.

The U.S. Gold Position Today

The trends and developments in the United States balance of payments and the ensuing gold outflow, together with the views and attitudes of other countries regarding the dollar, are matters of great import and significance to the American people and the country's monetary and fiscal authorities. They are also a vital matter for the entire Free World.

The dollar remains an exceptionally strong and desirable currency. As has been pointed out, gold certificate reserves at the Federal Reserve Banks in excess of their legal reserve requirements still stand at the princely sum of \$8 billion.

To be sure, the United States, as an international banker, owes foreigners more in dollars than it holds in excess gold reserves. But, while the U.S. is a debtor on short-term account, on long-term account it is a creditor. U.S. long-term investments abroad exceed by about \$35 billion the foreign investments in this country.

As has already been noted, gold bought this year by foreign countries as a whole has been purchased with currently acquired dollars, not by drawing down existing short-term dollar assets. Actually, foreign short-term dollar holdings have continued to increase. This is another way of saying that there has been no run on the dollar. Nor has there been evidence of any sizable liquidation of the \$8 billion portfolio investments held by foreigners at the end of 1957.

Americans as well as foreigners are aware of the large real resources and high productivity of the American economy. Furthermore, inflationary pressures have been, and may well remain, weaker in the United States than in many foreign countries.

The gold position of the United States, however strong, must not give rise to complacency. For one thing, the United States, like other countries, is exposed to emergencies that, among other consequences, might tend to reduce exports and unduly enlarge imports. And for another, a flight from the dollar — not only by foreigners but by Americans as well — might well be touched off if the idea gained ground that conditions were developing under which a rise in gold price would appear inevitable.

Because of the strategic importance of the United States and the dollar, foreign bankers, businessmen and investors are — understandably — watching how we handle our monetary and fiscal affairs. What counts is the determination of the United States Government and of the Federal Reserve System to safeguard economic and monetary stability and thus prevent — by deeds, and not by words alone — spread of doubts concerning the assured maintenance of dollar stability.

The fact that excess gold reserves are still so far above minimum requirements gives time — but not indefinite time — to repair policies that hurt trust in the dollar.

Ballots and Bonds

During the Congressional debate this summer over federal aid to education, a rather common plea was for the Federal Government to step in and end "the poverty of our schools" because its "superior revenues" enable it to do a job that states and municipalities cannot handle for lack of funds.

Such comments give the impression that the Federal Government has a magic money pool into which it can dip to pay for vast new projects. The hard fact, of course, is that, without resorting to the fraud of currency inflation, the Government cannot pay out a red penny that it has not previously taxed away from the people. And, as the taxes shuttle from the states to Washington and back, administrative expenses impose the inevitable bureaucratic "freight charges."

Moreover, heavy federal taxes tend to increase the taxpayer's reluctance to approve new local building and improvement programs. When an individual in comparatively modest circumstances must give up 10 per cent or more of his income to the Federal Government, and a business more than half of what it earns, it is understandable if local projects which will increase the tax burden are given extra-close scrutiny.

The results of last month's elections provide the latest evidence of this. Some 39 states presented voters with over 200 "questions" — including tax increases, new bond issues, and other more general proposals. Voters showed a cautious attitude toward new tax and spending programs. They had to be convinced that each project was necessary.

The bulk of the school building programs got a favorable reception — lending new support to the finding of Roger A. Freeman in his book published earlier this year, *School Needs in the Decade Ahead*:

The American people have loyally and faithfully supported their schools. The record of steeply increasing school revenues is nothing short of spectacular and makes no persuasive case for holding insufficient funds responsible for shortcomings in the product of our public school system.

Since the turn of the century enrollment has doubled, national income multiplied twenty-five fold, school expenditures multiplied sixty fold. School funds have increased much more rapidly than the gross national product, national income, personal consumption expenditures or any other economic yardstick.

Ballot Box Verdict

According to the *Daily Bond Buyer*, of the \$2.3 billion of bond issues on the ballot some \$1.7 billion (about 73 per cent) were approved. This dollar volume figure is swollen by such huge issues as the State of California's \$780 million of bonds and the Los Angeles Flood Control District's \$225 million, which together accounted for nearly half of the national total. In terms of the 473 individual bond issue proposals, voters turned down 200, or about 42 per cent.

The following results, picked at random, give some idea of the voters' selectivity on tax and bond proposals.

The electorate in Illinois rejected a \$75 million Korean War veterans bonus bond issue. Erie County, Pennsylvania, voters ratified a \$2.9 million infirmary expansion issue, but defeated a \$2.6 million prison improvement proposal. St. Paul, Minnesota, citizens turned down a proposed \$20.5 million bond issue for school improvements, while accepting a \$10 million borrowing for water facilities. They also defeated a charter amendment to raise tax levies for school and government operations.

Georgia vetoed amendments for taxes to pay for school lunches and for certain state employee retirement funds. It also rejected a proposal for the state to pay a \$100,000 prize to the first individual or company to come up with a way to stamp out the boll weevil.

Oregon turned down a measure allowing the state to build power plants and enter the power wholesaling business. Cleveland, Ohio rejected a \$15 million civic center. The electorate in Wauwatosa, Wisconsin favored \$4.4 million of bonds for schools, an incinerator, and storm sewers. All these projects had their supporters; they also cost money.

A Vote for Economy

Much has been written on the "significance" of the November 4 elections. Some political analysts contend that the "liberal tide" amounts to a clear mandate from the electorate for a bigger role for government — even if the price is heavier taxes, inflation, and further encroachment upon

the individual's freedom of choice in the disposition of his income.

The election results on local projects show the exercise of the democratic process as citizens in a state or community, best knowing its needs and counting the costs, decided what should be undertaken and what should be passed by. There is no doubt but that the numerous rejections of bond issues are a sign that people across the country are growing increasingly economy-conscious, sensitive to spending programs which mean new taxes or heavier debt burdens.

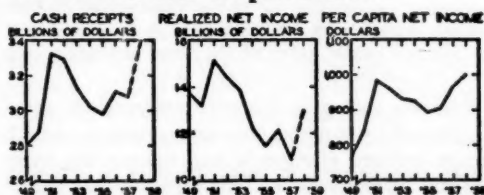
If the Federal Government takes the position that people have "needs" for projects they have turned down, it is repudiating the democratic process. By offering federal funds "for free" it is really trying to hoodwink them into thinking what does not stand up to reason—that Washington can finance out of thin air.

Towards a Freer Agriculture

The year 1958 has brought marked improvement in agriculture. Farmers' cash receipts from marketings are placed at about \$33 billion, 11 per cent above last year and close to the 1951 peak. Including Government payments, estimated at \$1.1 billion, 1958 farmers' total cash receipts are indicated at a record high of around \$34 billion.

More important, farmers' realized net income this year is officially estimated at about \$13 billion—20 per cent over 1957. Per capita income of the farm population from all sources is currently running at the highest level on record.

Responsible for this year's gains are higher prices, increased marketings (including delayed marketings of some 1957 crops), and larger U.S. Government payments—all of which have more than offset increased production costs. The chart below traces changes in these three farm income measurements over the past decade.



Farmers' Cash Receipts from Marketings and Government Payments, Realized Net Income, and Per Capita Net Income of the Farm Population (1958 Estimated).

The farm balance sheet presents a solid, highly solvent picture—as the following table brings out. Based on official estimates, farmers on January 1, 1959 will own real estate valued at \$123.2 billion; livestock, crops, equipment, etc., of \$58.1

billion; and cash and security investments of \$18.7 billion—a grand total of \$200 billion.

Against this, farm indebtedness is estimated at \$22.6 billion, leaving a net equity of \$177.4 billion, nearly \$11 billion above a year earlier. Indebtedness amounts to slightly over 11 per cent of total assets, against 19 per cent in 1940. In fact, farmers' holdings of cash and security investments alone, in the aggregate, are large enough to retire over 82 per cent of all farm debts.

Balance Sheet of U.S. Agriculture
(In Billion Dollars)

Assets	Jan. 1, 1940	Estimated Jan. 1, 1959	Net Change (per cent)
Real estate	35.6	123.2	+266
Livestock, crops, etc.	15.2	58.1	+282
Cash and investments	4.2	18.7	+346
Total	55.0	200.0	+277
Claims			
Real estate debt	6.6	11.2	+70
Non-real estate debt	8.4	11.4	+36
Proprietors' equities	40.0	177.4	+319
Total	55.0	200.0	+277

Source: U.S. Department of Agriculture.

Farm ownership is at a record high and two out of three farms are free of mortgage debt. Moreover, the family farm—politicians' alarums to the contrary notwithstanding—is still very much in evidence. While the decline in the total number of farms from 6.8 million in 1935 to less than 4.8 million today has reflected a trend to larger units, 96 per cent remain family operations—about the same percentage as 30 years ago. Meanwhile, the official index of farm real estate values on November 1 hit a record 163 (1947-49 = 100), 6 per cent above a year earlier.

It is true that some farmers—as in all types of competitive business enterprises—are having financial trouble. But such a condition is far from representative of commercial farmers generally.

Crop Harvest at New High

Despite the smallest plantings in 40 years, the U.S. Department of Agriculture (USDA) reports crop production this year "far exceeds anything yet reached."

The current harvest is estimated at a record 118 per cent of the 1947-49 average, 11 per cent above previous peaks. Responsible for the upsurge are record yields (43 per cent above the 1947-49 average) brought about by favorable growing conditions and farmers' increasing use of machines and modern know-how. Today's farm worker can produce in one hour what took two hours in 1940 and three hours in 1910.

Record harvests will, of course, mean higher incomes for many farmers. But for the Commodity Credit Corporation (CCC), the price sup-

port and surplus disposal agency of the USDA, they promise to aggravate an old headache by adding to crop surpluses. Even after vigorous and costly disposal programs, the CCC — as of last September 30 — had \$7.5 billion invested in surplus commodities, \$645 million more than a year earlier.

Moreover, this year's bumper harvest has caused the Budget Bureau to boost its estimate of government expenditures for price support and other farm programs during the current fiscal year which ends next June 30 to a record \$6.9 billion — \$2 billion above the last fiscal year. Federal outlays for all agricultural activities are exceeded only by those for national defense and interest on the public debt.

Despite these current and prospective heavy federal farm expenditures, the USDA has predicted that net farm income in 1959 may be from 5 to 10 per cent below 1958. However, the upward trends in land values, farm assets, and living standards are expected to continue.

The prospective drop in net farm income next year is due to expected larger marketings and lower prices for hogs, discontinuance of Soil Bank acreage reserve payments, and somewhat higher production expenses. Also, the rising surpluses of farm crops, particularly wheat and feed grains, will be a depressing factor.

High Supports — a World War II Hangover

In view of the rising surpluses, more and more people are wondering how long the Government can continue the practice of supporting farm product prices at unrealistically high levels.

High price props have had more lives than the proverbial cat. World War II legislation calling for rigid farm supports at 90 per cent of parity expired at the end of 1948. But a return to lower props was repeatedly postponed; flexible, lower supports were always scheduled for "next year," but "next year" never seemed to arrive. Either Congress or the Secretary of Agriculture, exercising his discretionary authority, saw fit to continue high supports because some "national emergency" required high farm output.

Rigid supports were not lifted until the Agricultural Act of 1954. It provided flexible supports ranging from 82½ to 90 per cent of parity on five major crops in 1955 with the floor, supply-demand conditions warranting, dropping to 75 per cent of parity beginning in 1956. As it has worked out, however, supports did not drop to the 75 per cent level until this year — and then for only two crops (wheat and rice). Even the 75 per cent level, however, is — as shown by the

mounting crop surpluses — too high to encourage the needed adjustments within agriculture.

Aware of the need for supports to flex lower, President Eisenhower last January asked Congress to lower the support floor on basic crops to 60 per cent of parity and to abolish escalator clauses that require supports to be raised as surpluses are worked down.

Congress rejected this request and in March, as a so-called anti-recession measure, passed a bill freezing price props on 1958 crops at last year's higher level. President Eisenhower promptly vetoed the bill, stating "what the farm economy needs is a thaw rather than a freeze."

After this veto, chances for new farm legislation appeared slim. Finally, however, in the closing days of the session, the Congress and the Administration agreed on a farm bill moving toward Administration objectives, and the President signed it into law on August 28.

The Agricultural Act of 1958

Although it is not all the Administration sought, the new law is based on the principle that greater flexibility in price supports will lead to expanded markets. The following is a compressed summary of its three major provisions.

(1) **COTTON:** A minimum national acreage allotment of 16 million acres takes effect in 1959, against less than 14 million indicated under prior law. Growers complying with allotments to receive price support in '59 at a minimum of 80 per cent of parity, the support thereafter dropping 5 points a year to a minimum of 65 per cent by 1962. Next year and in '60 farmers can choose to grow up to 40 per cent more than their share of the national allotment, but at price supports 15 parity points lower than those for complying farmers.

Starting with the '61 crop, price supports to be set without regard to supplies, thus eliminating the escalator clause.

(2) **CORN:** Provision for a referendum of corn producers (held November 25) in which farmers were given two choices: (1) continuation of present acreage controls with price supports at 75-90 per cent of parity, depending on supplies, or (2) a new program of no acreage controls with price supports at 90 per cent of the average market price of the three preceding crop years, but not less than 65 per cent of parity.

Farmers voting in the corn referendum overwhelmingly approved the new program, which scraps acreage allotments and adopts the more realistic price formula. This decision was hailed by Mr. Benson as evidence of farmer willingness to move towards a freer agriculture.

(3) **RICE:** Minimum national acreage allotments in effect in '57 and this year to be extended indefinitely. Minimum supports in 1959 and '60 are to remain at this year's 75 per cent of parity; the minimum in 1961 to drop to 70 per cent, and thereafter to 65 per cent, with termination of mandatory escalation after 1958.

The new law has two outstanding weaknesses. It does nothing about the three other so-called basic crops — wheat (our biggest surplus), tobacco, and peanuts. Also, the lowest support levels are not authorized until 1961 and 1962, affording time for the farm bloc in Congress to try to push through higher props.

The Benson Victory

Several factors contributed to Secretary Benson's victory over the Congressional farm bloc last summer.

Farmers themselves have become increasingly aware that acreage controls will not keep crop production down as long as price supports encourage growers to step-up output on their remaining land. Moreover, although much land has been kept out of restricted wheat and cotton, it has been used for other crops — thereby increasing overall surpluses.

There has been some growing farmer disenchantment with government acreage allotments. For example, cotton plantings this year were held down to less than half the number of acres planted in 1951.

U.S. cotton manufacturers have been discriminated against because their competitors abroad have been able to buy raw material (surplus U.S. cotton) at prices substantially below what mills in this country have had to pay.

Persuaded that lower supports and increased acreage were in their best interest, both cotton producers and cotton mills backed Secretary Benson. The same proved true of rice farmers and the rice trade.

Too Many People in Agriculture

Despite the recent progress toward freer agriculture, the farm surplus problem, as previously indicated, will likely get worse before it gets better. A basic reason is the difficulty of reconciling price support laws with the varying degrees of farm efficiency.

Most progressive farmers, by applying modern techniques, are producing at relatively low cost. Speaking of such farmers, Dr. Herrell DeGraff, of Cornell University, noted in a speech before the American Bankers Association in September:

Probably no acceptable level of price supports could be devised that would not be an incentive level to such a leadership group, even though low enough to be attacked politically as disastrous support levels for less efficient farmers.

This is the very essence of the reason that price supports will never provide a satisfactory solution to what is widely looked on as the income problem of agriculture. Support levels that would make less efficient farmers profitable will always be so high as to force pro-

duction controls on the leadership group. In other words, support prices will perpetuate inefficient production and will also force inefficiencies on the leadership groups which would be more efficient with no price support at all.

All this serves to demonstrate anew the basic difficulty — the nation's farm plant is larger than required to meet present needs. While anticipated population increases will mean more mouths to feed and backs to clothe, farm technology is expected to keep pace — at the very least. Hence, the need for speeding up the long-term shift of people and perhaps even some resources out of agriculture.

This does not mean that the family farm is on the way out. As Dr. Theodore Schultz of the University of Chicago stated last December:

It is an error . . . to infer that the family-sized farm has not and cannot adapt itself to the new economic circumstances facing U.S. agriculture.

We face not a decision to shift rapidly to the type of farming in which non-family farms predominate. Instead, the central problem is that we have too much human effort committed to farming, despite the fact that the out-migration has been very rapid. . . .

The shift of marginal operators out of farming and consolidation of our farm plant in fewer, more efficient units would make possible passing along some of the benefits of low cost methods in the form of lower prices to the consumer at home and more competitive prices for American farm products in world markets.

Such occupational shifts cannot, of course, be accomplished overnight. Most older people on farms may elect to remain farmers until they can collect their Social Security pensions, as many farmers chose to do when they became eligible for such benefits in 1956. To some extent, the shift will be accomplished by farmers who find they can do better at city and town jobs than they are doing in farming. Perhaps more important in the long run will be the transition brought about by the larger proportion of the younger generation seeking off-farm jobs.

For those wanting, and in a position, to move out of farming, current record high prices for farm real estate afford opportunities for sale of such properties to advantage. The situation in this respect is totally different from that in the depressed '30s when farmers were having to dispose of their farms at bankruptcy prices.

The business recession, from which the country is now emerging, must not cause sight to be lost of what is a desirable development in the longer run. Taking the longer view, growth of employment opportunities is certain to be more rapid in nonfarm than in farm pursuits. This is only in accord with past experience.

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